IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 933

THE WESTERN UNION TELEGRAPH COMPANY,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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STATUTES

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Judicial Code (As amended by the Act of February 3, 1925):

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TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petitioner respectfully prays that a writ of certiorari issue to review the decision of the United States circuit court of appeals for the second circuit handed down on March 23, 1944, in the case entitled Commissioner of Internal Revenue against The Western Union Telegraph Company, No. 57 October term, 1943, in so far as it reverses the decision of the tax court.

Jurisdiction

The jurisdiction of this court is invoked under section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A., Sec. 347).

Opinions Below

The opinion of the United States board of tax appeals (now the tax court) (R. 160-164) is not officially reported.

The opinion of the circuit court of appeals for the second circuit reversing, in part, the decision of the United

States tax court, entered July 25, 1942 (R. 164), was handed down March 23, 1944, and is not officially reported, but is set forth in full in the record.

Statute Involved

The statute involved is the Revenue Act of 1928, c. 852, 45 Stat. 791, and provides, as far as material herein:

> Sec. 311. TRANSFER ASSETS.[1]
>
> (a) Method of collection.—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):
>
> (1) Transferees.—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this title.
>
> * * * * * * *
>
> Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.
>
> * * * * * * *
>
> (f) Definition of "transferee."—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

Question Presented

Where by the State law a corporate lease made before the Sixteenth Amendment, without fraud or intent to evade taxes, has the effect of completely and irrevocably divesting

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[1] Section 311 of the Revenue Act of 1932, c. 209, 47 Stat. 169, is identical.

the lessor of all property rights in the future rents and vesting such rights in the lessor's stockholders as against the lessor and its creditors, and where the lessee, in pursuance of its legal duty to do so, has paid such rents to the stockholders, the Government having made no attempt to enjoin such payment, may the Government afterwards, in transferee proceedings to collect the lessor's taxes, require the stockholders to give up the amounts so paid?

Statement of the Case

Long before the Sixteenth Amendment, when there were no income taxes and when an income tax on rents would have been unconstitutional, the Gold and Stock Telegraph Company, a New York corporation, leased all its property to the Western Union, a New York corporation, for ninety-nine years (R. 189-196). The lease provided that the rents should be paid by the lessee, pro rata, directly to the lessor's stockholders, and the stock certificates were endorsed with a "guarantee" (construed by the New York courts as a primary obligation) to pay the rent proportionately directly to the stockholders in accordance with the terms of the lease. The property leased was principally in New York. In case of default the lessor might terminate the lease and recover possession of the leased property, but the lessee was nevertheless required to continue, for the full term, the payments to the lessor's stockholders. The rent was payable at the office of the lessee, the Western Union, in the City of New York.

The five other telegraph companies involved, namely, the Pacific and Atlantic, the New York Mutual (through its predecessor the Mutual Union), the Southern and Atlantic, the Empire and Bay States, and the Franklin, made similar leases to Western Union (R. 282-286; 320-333; 364-367; 400-408; 436-441). The summary of the Gold and Stock

lease may be taken as substantially typical of all, although there were some differences in detail.[2]

The legal incidents of such a lease, under New York law, which until now has always been supposed to be applicable and controlling with respect to the ownership of the rents and the right of the lessor company or its creditors to divert them from the stockholders, are well settled,[3] and it is conceded that the New York law has not changed.[4] These incidents are as follows: (1) the rent belongs to the stockholders, and the lessor has no property interest in it whatever until default; (2) the several stockholders, not the lessor, are the only proper parties plaintiff in actions for unpaid rent; (3) the lessor cannot require the lessee to pay the rent to itself, and no stockholder can be deprived of his share of the rent, without his own consent, either by the action of the lessor alone or even by a supplemental agreement between the lessor and the lessee, unless the lessor has first terminated the lease for default.

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[2] The Pacific and Atlantic was a Pennsylvania corporation. The Franklin will be omitted from this discussion; all tax controversies with respect to that company have been or are in the process of being adjusted. Two of the leases are for nine hundred and ninety-nine years instead of ninety-nine. In two cases there were no endorsements on the certificates. Except in the case of the Gold and Stock, if the lessor terminated the lease the lessee was not required to contiue to pay rent. In two of the cases the property leased was outside New York. The provision that the rent should be paid at Western Union's office in the City of New York was expressly made in three of the leases, including the Pacific and Atlantic, but necessarily implied in all.

[3] The New York cases are fully reviewed in *W. U.* v. *Commissioner*, 68 F. (2d) 16, certiorari denied 292 U. S. 636 (1934), and some are referred to in the lower court's opinion.

[4] Or the lower court could not have sustained the defense of *res judicata*. See infra, p. 6.

The circuit court of appeals has recognized and applied these principles of New York law, in connection with leases of this character, in a long line of decisions. It has held that where both lessor and lessee are in receivership, the rent must continue to be paid to the lessor's stockholders and not to the lessor's receiver;[5] that the Government, as a creditor of the lessor for taxes, cannot enjoin the lessee from paying the rent to the stockholders and require it to be paid in satisfaction of the tax claim;[6] that the stockholders cannot be deprived of rent already paid to them in the absence of an injunction on the theory that they are transferees.[7]

It has been settled in this circuit since 1918,[8] long before this court had passed on the question, that in spite of the fact that the rent was owned by the stockholders and the lessor company had no property interest in it the lessor was nevertheless subject to liability for Federal income taxes, measured by the amount of the rent paid to the stockholders. But since the lessor companies could not control the rents and had no other property (except their reversionary rights after the leases), and since the lessee was not obligated by the terms of the leases to pay income taxes, if any, assessed against the lessors, the taxes have been unpaid for many years. Under the New York rule deductions could have been made by the lessee from rentals to pay taxes only by consent of the stockholders to whom these rental payments were due. Obviously no group of stockholders less than all would assume this burden, and as

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[5] *Pennsylvania Steel Co.* v. *N. Y. City Ry. Co.*, 198 Fed. 721, 762 (1912).

[6] *United States* v. *Western Union et al.*, 50 F. (2) 102 (1931). But see *United States* v. *Warren Railroad*, 127 F. (2) 134, (1942); *United States* v. *Morris & Essex Railroad*, 135 F. (2) 711 (1943).

[7] *Western Union* v. *Commissioner*, 68 F. (2) 16 (1933); *Harwood* v. *Eaton*, 68 F. (2) 12 (1933); certiorari denied, 292 U. S. 636 (1934).

[8] *Rensselaer and Saratoga R.R.* v. *Irwin*, 249 F. 726.

there are thousands of stockholders scattered through many states, unanimous consent has never been a practical possibility.

The present proceedings are transferee proceedings which were instituted by the Government with the avowed intention of inducing the circuit court of appeals to overrule its former decisions and to hold that the stockholders were transferees. The Western Union, the lessee, is named in each case as a transferee because in each case it is a stockholder of the lessor company; its stock interest ranging from about sixty per cent in the Gold and Stock to about six per cent in the Empire and Bay States.

The circuit court of appeals has now held, as to the leases of the Gold and Stock and the Pacific and Atlantic, which were involved in the prior transferee proceedings and in respect of which final judgment in favor of Western Union was entered in those proceedings[9], which this court refused to review[10]. that the principle of res judicata applies, and on that ground alone has affirmed the decision of the tax court in favor of Western Union.

As to the other four leases the majority of the court, with what is in form a concurrence but is virtually a dissent by Judge Swan, has agreed with the Government that its prior decisions should be overruled and transferee liability upheld. In reaching this conclusion the court concedes that the New York law has not changed, and that by the New York law the property right in the rent is in the stockholders and not in the lessor companies. But the court holds that this court's decision in *United States* v. *Joliet and Chicago Railroad Company*, 315 U. S. 44 (1942), establishes the principle that the State law as to the ownership of the property is not controlling in a case of this kind on the question whether the property may be reached for the lessor's taxes; that the question is one of Federal law; and that under the Joliet decision, since the rights of the stockholders are derived from the lessor companies, the situa-

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[9] *Western Union* v. *Commissioner*, 68 F. (2d) 16 (1933).

[10] 292 U. S. 636 (1934).

tion must be viewed as though each payment of rent, when made, had been a transfer directly from the lessor to its own stockholders as an illegal dividend and consequently a constructive fraud on creditors, although the absence of any actual fraud or improper conduct or intent is conceded.

There is no dispute that the lessor company had no physical power or legal right to interfere with or prevent the payment of rent to the stockholders when due. If the lessee had not paid the stockholders, each stockholder would have been entitled to recover judgment for the rent, with interest and costs, in an action at law to which the lessee would have had no defence. If the default had continued, the lessor in each case could have terminated the lease.

Though it is true, as the lower court says in its opinion, that Western Union claimed in its own income tax returns, as deductions for rent, the full amount which it had agreed to pay under the leases, and returned as dividends the part of the rent allocable to the stock owned by it, that should not be allowed to confuse the issue. As was fully explained to the court below in brief and argument, Western Union's tax returns were drawn in this way in compliance with the insistence of the commissioner; there has been a consistent disclaimer of any belief by Western Union that it was entitled to the full deduction (see 1931 return, R. 201); and Western Union has had no actual advantage from such claim because in the only year in which it had a net income subject to tax, which is now closed, the gross deduction was disallowed (R. 187-188). The same point was made in the prior transferee cases, and Western Union then as now disclaimed any right to insist on the gross deductions and declared its willingness to restate the accounts, which the court in the prior case directed should be done.[11]

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[11] "and its deduction on account of rent will be reduced by so much as its ownership of the lessor's share has lessened its annual payments of rental,"

Western Union v. *Commissioner*, 68 F. (2d) 16, 18 (1933).

Reasons for Granting the Writ

1. The lower court has misconstrued and misapplied the decision of this court in *United States* v. *Joliet and Chicago Railroad,* 315 U. S. 44 (1942), and for that sole reason has overruled its former decisions, which this court had refused to disturb, and which otherwise it should and would have reaffirmed.

2. The decision is in conflict with the highest court of the State on an important matter of local law, namely, whether the lessors' stockholders are entitled to hold the rents which they own and have received, and in which the lessors by the local law have no property rights whatever, as against the lessors and their creditors.

3. The conflict with the State courts is not avoided because the lower court recognizes that the legal title to the rents is in the stockholders and holds that it is subject to an equitable flaw because of an imaginary fraud, since the question whether such equitable flaw exists is as much a question of State law as the question of technical legal title; and the lower court should have ascertained and applied the State law on this point and could not properly treat it as a Federal question.

4. If the lower court can be assumed to have decided any purely Federal question, it must be that property exclusively owned by the stockholders may be taken to pay the lessors' taxes. If so regarded the decision is probably in conflict with applicable decisions of this court, is certainly not supported by any decision of this court, and is so revolutionary and so important that the question should be settled by this court.

5. Neither the conflict with the State courts nor with this court, as the case may be, is avoided by the lower

court's conclusion that it is proper to treat the case *as though* the lessor had retained full control of the rents and had made fresh transfers to its stockholders as each installment of rent fell due.

6. If the question is at all doubtful transferee liability should not be upheld, because of the appalling multiplicity of suits which it will entail and the disproportionate hardship which will result to thousands of stockholders. If the Government has a substantive right to reach these rents for taxes it should be required to resort to another adequate and complete remedy.

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BRIEF AND ARGUMENT

1. The lower court has misconstrued and misapplied the decision of this court in *United States* v. *Joliet and Chicago Railroad*, 315 U. S. 44 (1942), and for that sole reason has overruled its former decisions, which this court had refused to disturb, and which otherwise it should and would have reaffirmed.

United States v. *Joliet and Chicago Railroad* involved no question of tax collection, and certainly not the question whether one taxpayer's property could be taken to pay the tax of another. It was concerned solely with the question of tax liability, and held that the lessor companies in cases like these were subject to a tax measured by the amount of the rent paid to their stockholders. There was nothing new about this doctrine. It had been the law in the second circuit since 1918, *Rensselaer etc. Railroad* v. *Irwin*, 249 F. 726, and the court of appeals for the second circuit had steadily refused to depart from it. It was assumed to be the law when the first transferee cases were decided in favor of the stockholders. It was later reaffirmed by that court in *Gold and Stock* v. *Commissioner*, 83 F. (2d) 465 (1936), in spite of the decisions in the transferee cases, and on the assumption on all sides that the taxes could never be collected out of the rents and in the case of some of the lessors at least could never be collected at all.[1]

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[1] In applying for certiorari in *Harwood* v. *Eaton*, 68 F. (2d) 12 (1933) the Solicitor General said: "If the decision of the court below be allowed to stand it will result that the Government is without a practical remedy for the collection of taxes upon the rentals due to the lessor. * * * there are now pending a large number of cases involving approximately one and three-quarters of a million in taxes, the disposition of which depends on the correct answer to this question. Otherwise the Treasury Department is placed in a position which renders the proper administration under revenue laws in cases of this character impossible until this problem is solved by a decision of this court * * *".

The *Joliet* case was taken by this court because the court of appeals for the seventh circuit had decided otherwise, and the decision merely reaffirmed the correctness of the rule laid down in the second circuit as to tax liability.

No question of collection could have been presented, for in the Joliet lease the lessee had expressly covenanted to pay the lessor's income taxes if any, and the taxes had been paid and the suit was a suit for refund.

All the remarks of this court therefore are to be read in the light of the only issue presented. That this court never meant to say that because the rights of the stockholders were "derivative in origin" the money received by the stockholders could be taken for their lessor's debts is evident from the fact that it relied on *Lucas* v. *Earl,* 281 U. S. 111, and quoted with approval the famous passage:

> "There is no doubt that the statute could tax salaries to those who earn them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised *to prevent the salary when paid from vesting even for a second in the man who earned it.*"

If money never vests even for a second in the taxpayer it cannot be taken to pay his taxes. At any rate that it can be so taken has never before been asserted, much less held; and certainly it was not so held by this court in the *Joliet* case.

There are many classes of cases—the *Joliet* case and the present cases are one class—in which money due and paid to B has been held to constitute income to A. Familiar examples are assignments of wages, trusts for dependents, and payment by contract of the taxpayer's debts. But the point completely overlooked by the lower court is that in *all* such cases the property right in the money when paid is in B, not A, and it has never been asserted before that it could be taken away from B to pay A's tax. We say that in *all* such cases the property right is in B, even though the

income is regarded as A's income; for if it were conceded that it was A's property—that is, if the money were paid to B as A's agent, or under a revocable authority from A—it would never have been necessary for a court to decide whether A was taxable for it. That would be self-evident: the problem as to *income* arose in each case because the *money* belonged to some one else.

The *Joliet* case therefore afforded no reason and no justification for overruling the prior decisions against transferee liability, which this court had refused to disturb.

2. The decision is in conflict with the highest court of the State on an important matter of local law, namely, whether the lessors's stockholders are entitled to hold the rents which they own and have received, and in which the lessors by the local law have no property rights whatever, as against the lessors and their creditors.

The lower court appears to have concluded that it had done its full duty as a Federal court in its relation to the State courts when it conceded that by the State law the title to the rents was in the stockholders and that the lessor had no property rights with regard to them until default.

But the question of State law, as to which the State decisions are controlling, was not merely a question of abstract title. The question was whether the stockholders, who had received these rents when due, were entitled to hold them against the lessor and its creditors. In a New York State court they could; if in a Federal court they cannot, there is a plain conflict between the decision of the Federal court and the State rule. The answer to the question did not depend on any Federal law or Federal grant. It depended on the view taken by the State courts of the legal relationships created by the lease and the subsequent payments in New York of rentals thereunder. If the suit had been one for the recovery of property and the Federal court had determined that by the State law the property

belonged to the plaintiff, but without further discussion or explanation had rendered a judgment for the defendant, the conflict would be not the less real because the Federal court has paid lip service to the State law by stating what it is and then disregarding it in its judgment.

3. The conflict with the State courts is not avoided because the lower court recognizes that the legal title to the rents is in the stockholders and holds that it is subject to an equitable flaw because of an imaginary fraud, since the question whether such equitable flaw exists is as much a question of State law as the question of technical legal title; and the lower court should have ascertained and applied the State law on this point and could not properly treat it as a Federal question.

The lower court recognizes that the legal title to the rents is in the stockholders, not the lessors, and that ordinarily the creditors of the lessors can stand in no better position with respect to claims against third parties than the lessors did. But it was conceded by petitioner on the argument that this principle did not apply if the lessors had conspired with a third party to transfer assets in fraud of creditors; and it is on this theory that the lower court seeks to avoid the rule that as the lessors here could not have reached the rents before the tax liability arose their creditors cannot reach them now. The lower court says that the case should be treated as though the lessor had retained full control of its rents and had made fresh transfers to the stockholders after its indebtedness to the Government arose, as each installment of rent fell due.

But whether the case may properly be so regarded is as much a question of State law as the question of bare legal title. It was the duty of a Federal court, if this theory was thought worthy of consideration, to endeavor to ascertain what view would probably be taken of that question by the New York courts, and to apply the State rule as thus ascertained. In no circumstances was it authorized to determine as a principle of Federal law that this transaction must

have that legal effect in all States. There is no basis for holding that the New York courts would take this view; but in the view of the case most favorable to the Government the judgment should be reversed and the lower court directed to ascertain the State law and be guided by it.

> "In deciding local questions it is the duty of the Federal court to ascertain from all available data what the State law is and apply it, however superior a different rule may appear from the viewpoint of general law and however much the State rule may have departed from prior decisions of the Federal courts. * * * No special circumstances are shown effective under Ohio law to limit the time of demand or shorten the statutory period after demand * * *", *West* v. *AT&T Co.*, 311 U. S. 223, 224, 225 (1940).

The decision below, in connection with the previous decisions of the same court in *U. S.* v. *Morris and Essex Railroad*, 135 F. (2d) 711, and *U. S.* v. *Warren Railroad*, 127 F. (2d) 134, was obviously intended to apply not only to claims by the Government for taxes but also to claims by private judgment creditors. If this were the suit of a private judgment creditor there can be no pretense that anything but the State law would determine whether the title of the stockholders could be defeated on the ground of imaginary fraud. So far as we know it has never been held that, apart from its priority, the Government has any greater rights than any other creditor against property transferred by judgment debtors before they became insolvent." A remark by this court in *Phillips* v. *Commissioner*, 283 U. S. 589, which the lower court says was to the effect that *the general question was reserved* "whether the right of the United States to follow transferred assets is limited by * * * State laws" is referred to in the opinion, but we

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[2] The contrary was held by the lower court in *United States* v. *Western Union and Northwestern*, 50 F. (2d) 102 (1931), *supra*.

think was misapprehended.[3] At any rate in the *Phillips* case it was found that the State laws justified the Government's contention, and if the present decision is intended to decide the question which this court is supposed to have reserved, and to hold for the first time that State laws of property may be ignored because in form this is a transferee proceeding, the question is certainly of sufficient importance to merit review so that it may be settled by this court.

4. If the lower court can be assumed to have decided any purely Federal question, it must be that property exclusively owned by the stockholders may be taken to pay the lessors' taxes. If so regarded the decision is probably in conflict with applicable decisions of this court, is certainly not supported by any decision of this court, and is so revolutionary and so important that the question should be settled by this court.

If the lower court's decision can be supposed to have recognized squarely that the State law is against the Government, both as to the legal title and the supposed equitable flaw, and to have determined that the State law as to the ownership of the property, legally and equitably, is immaterial here and may be disregarded, then it can mean

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[3] There was no affirmative reservation of any such question in the *Phillips* case. The taxpayer contended that the transferee procedure was unconstitutional because it delegated the Federal taxing power to the various States. This court said: "The extent and incidence of Federal taxes not infrequently are affected by differences in State laws; but such variations do not infringe the constitutional prohibitions against delegation of the taxing power or the requirement of geographical uniformity. * * * *We have, therefore, no occasion to decide* whether the right of the United States to follow transferred assets is limited by any State laws." For instance, State statutes of limitation, which were expressly held not to apply. But there is no hint that the question of title to property, which was controlled by State law even before *Erie Railroad* v. *Tompkins*, may be dealt with as a Federal question in a transferee proceeding though not in others.

nothing more nor less than that, in these circumstances, Congress has authorized the Government to take B's property to pay A's tax. For as the lower court has said before, *Harwood* v. *Eaton, supra,* "in general, the rule is that the corporation is an entity distinct from its stockholders for tax purposes. *Dalton* v. *Bowers,* 287 U. S. 404, 410. Hence a stockholder can be compelled to pay a tax assessed against his corporation only as might any third person who had in some way incurred liability therefor."

This court has held many times that money paid to B and owned by B—never "vesting even for a second" in A—may, as in these cases, constitute A's income. But it has steadily refused to hold that if the money paid to B does not come within any of these categories, and is not only B's money but also B's income, it may be used to measure the tax assessed against A.

Hoeper v. *Tax Commission of Wisconsin,* 284 U. S. 206 (1931); *Heiner* v. *Donnan,* 285 U. S. 312 (1932); *Poe* v. *Seaborn,* 282 U. S. 101 (1930).

As was said in the *Hoeper* case, which involved a State income tax law:

> "* * * any attempt by a State to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law * * *". 284 U. S. at page 215.

The reason why one person cannot be assessed because of another's income is not because he is particularly hurt by the assessment, but because he may reasonably apprehend that his property will be taken for the tax. To take his property for another's tax without the intervening formality of making an improper assessment against him, and when the tax is correctly assessed against the other, is certainly no less a violation of the Fifth Amendment than if he had first been improperly assessed.

The rule that one taxpayer's property cannot be taken for another's tax is as applicable with respect to stock-

holders and their corporation as to other classes of taxpayers. There is no Federal policy that stockholders shall be personally liable for their corporation's debts, unless as in *Anderson* v. *Abbott*, U. S. (March 6, 1944), they are stockholders of national banks.

While we have not found any case in which any one has had the temerity to assert in this court that A's property may be taken for a tax assessed against B, the general rule that it cannot be has frequently been stated (see 61 Corpus Juris 1042: "It is a general rule that the property of one person cannot be seized and sold for taxes due from another person"); and a holding to the contrary without some special justification is clearly in conflict with the principles laid down by this court in the cases cited above, and many others to the same effect.

The question resolves itself then into whether the ground on which the lower court relied can constitute any reasonable justification for the departure from the recognized principle.

That reason is that this court's decision in the *Joliet* case

> "requires us to hold that the lessor not only exists as an entity independent of its stockholders, but that it constructively receives rentals from the lessee *and in effect distributes them as annual dividends to its shareholders* * * *. The situation was the same as though the directors in the first year of the lease had passed a resolution that the rents each year thereafter should be paid to the shareholders without further order of the directors. Under the arrangement, each year after the income tax law went into effect, the lessor distributed its earnings as dividends without paying its current indebtedness for income taxes. *If such be the correct rationale in view of the Joliet decision*, there was a fraudulent conveyance each year, which the Government could have set aside in equity—and this in spite of the entire good faith of the parties involved."

But this is no more than to say that, where the only wrong that could have occurred was a fraudulent transfer, the court will arbitrarily treat the wrong as having been committed although no transfer, fraudulent or otherwise, was made. It is no more than to say that the same consequences will be attached, arbitrarily, to a transfer made by a person while solvent as to one by him when insolvent. The case cannot be treated as though the direction to pay rent to the stockholders had been a mere revocable direction, for in that case the directors could not, without incurring criminal as well as civil responsibility, have failed to revoke the direction and the controversy could not have arisen. We have already pointed out that the *Joliet* case requires no such conclusion. What this court decided in the *Joliet* case was that since the rentals were due and paid the stockholders because they were stockholders there was such a relationship between the payments and the lessors as to justify ascribing of the income to the lessors for the purpose of taxation. If the lower court's conclusion is valid it must apply not only in these cases but in all other cases of constructive income. Assignees of the taxpayer's earnings, the beneficiaries of trusts created by him (while solvent) for dependents, and his creditors who receive payment of their debts from third parties under contract, can all be required to give up the money so received to the Government and to other creditors.

If this is to be the law the principle is important and far-reaching enough to be announced by this court, and not permitted to become effective as the result of a decision of a single circuit court of appeals, by what is in substance a divided vote, and which has overruled a long line of contrary decisions on the faith of which stocks have changed hands for many years.

In no previous case has a court of equity ever set aside, as constructively fraudulent, a payment of money which the person paying was under a legal obligation to make, and which a court would have compelled if it had not been made.

If the Government had obtained an injunction restraining these payments, it would have been the duty of the lessee to obey the injunction: in the absence of any injunction it was the duty of the lessee to pay the rent to the stockholders. No executed transfer can properly be set aside unless it was wrong at the time when it was made. A transferee proceeding, like the judgment creditor's action for which it is a summary substitute, presupposes an equitable tort. Some one must have done something he should not have done, or failed to do something he should have done. That is not the case here.

5. Neither the conflict with the State courts nor with this court, as the case may be, is avoided by the lower court's conclusion that it is proper to treat the case *as though* the lessor had retained full control of the rents and had made fresh transfers to its stockholders as each installment of rent fell due.

The point has really been covered by what has been said under point 4.

If A, while perfectly solvent, creates a trust fund for his dependents, he may sometimes be taxed on the income as it is paid to the beneficiaries. If a Federal court were to hold for the first time that when he subsequently becomes insolvent the payments of income made thereafter may be seized by the Government in satisfaction of the tax assessed against the donor for prior payments, we respectfully urge that the decision would be one which this court should review. And we do not think that review should be declined because the reason assigned for the result is that the transaction should be treated as though the donor had retained full control of the trust fund and had created fresh trusts with respect to each installment of income after his insolvency.

6. If the question is at all doubtful transferee liability should not be upheld, because of the appalling multiplicity of suits which it will entail and the disproportionate hardship which will result to thousands of stockholders. If the Government has a substantive right to reach these rents for taxes it should be required to resort to another adequate and complete remedy.

Transferee proceedings are adapted to dissolutions, where there is a single transfer or a group of transfers at about the same time, and where each person held liable as a transferee can protect himself against liability for more than his share by a single suit for contribution, or as many simultaneous suits as may be necessary because of considerations of venue.

They are inequitable and work great hardship if applied to continuing payments of rental under long-term leases which must go on quarterly or semiannually for many years to come.

Stockholders who pay as transferees are entitled to contribution from other stockholders, but this remedy in a case of this kind can never be adequate. There are thousands of stockholders involved, and they are scattered through many States. Foreign stockholders will no doubt escape entirely. So will the stockholders in States where there are so few of them that a contribution suit will not pay its way. The burden of contribution will not be borne by all in proportion to their interests, for some of the stockholders of previous years will not be found and many will be insolvent. The time of the State courts will be taken up for years to come with these suits; they will not merely multiply but proliferate. But what makes the remedy especially inequitable in this particular case is this:

The years involved are 1931, 1932 and 1933. During those years and the intervening years before this proceeding was commenced these stockholders, in pursuance of the

Treasury regulation,[4] have been reporting their rents as income and paying taxes and surtaxes on them. If they are subject to transferee liability, directly or by way of contribution, they apparently are entitled to no tax deductions for the payments so made; and since, in reliance on the prior decisions of the court that the rents cannot be taken for taxes, they have made no claims for refund, they cannot now recover what they have already paid and will frequently (depending on their respective surtax brackets) find that they have paid out in taxes, including interest, more than they have received.

This is a harsh and inequitable result. It should not be countenanced, in view of the fact that, if the Government should be permitted to reach the rents for taxes, it has another adequate remedy, namely, injunctions to restrain the payments before they have been made. The lower court has already held that it will issue such injunctions (*U. S.* v. *Warren Railroad* and *U. S.* v. *Morris and Essex, supra.*) While we think that those decisions are wrong, because we do not think that the rent owned by the stockholders can properly be taken to pay the lessor's taxes by any form of procedure,[5] this method at least would distribute the burden equitably and not ruin many small stockholders who cannot find the capital to pay an ancient obligation which, relying on the lower court's previous decisions, they never expected to pay.

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[4] Article 70, Reg. 74, Rev. Act 1928; Article 70, Reg. 77, Rev. Act 1932. The stockholders are required to report rental payments received under these circumstances as dividends, without any exception of cases in which the lessor corporation's taxes have not been paid.

[5] The State law views these leases as intended by all parties to assure the continued payment of rent to the stockholders, whether their lessor company afterwards contracts debts or not, if such an arrangement can lawfully be made; and by the State law it can lawfully be made.

Government counsel during the argument suggested that this remedy might not be adequate because some arrangement might be made between Western Union and the stockholders for some exchange of securities which would terminate the leases and prevent future rents from accruing. But no such arrangement could be made without a provision for the payment of past taxes, which would otherwise constitute liens on the physical property and at once become collectible.

CONCLUSION

Certiorari Should Be Granted.

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